

REPORT ON THE YEAR 2000 OPERATION OF THE ENERGY REGULATORY COMMISSION OF THE REPUBLIC OF ARMENIA

Introduction

The Energy Regulatory Commission of the Republic of Armenia (hereinafter referred to as the Commission) is a regulatory body in the energy sector, which operates within the authorities bestowed upon it by the RoA Energy Law and other legal and normative acts.

The Chairman and Deputy Chairman of the Commission, as well as three Commissioners were appointed by relevant Decrees of the President of Republic of Armenia. Main objectives and authorities of the Commission are set forth in the RoA Energy Law. The Chairman, Deputy Chairman and the Commissioners are given below:

Vardan Movsesyan	Chairman
Nikolay Grigoryan	Deputy Chairman
Ashot Hovsepyan	Commissioner
Robert Kharazyan	Commissioner
Shiraz Kirakosyan	Commissioner

The Commission performs its activities with the help of the Commission's staff (52 employees), which has the following structure:

- Tariff policy department;
- Legal and licensing monitoring department;
- Public relations;
- Human resource.

Objectives of State Regulation in the RoA Energy Sector

The RoA Energy Law separates economic activities, state management and regulation functions in the energy sector. The objectives and authorities of the Commission, as a regulatory body, can be presented in a summarized group of functions:

➤ Tariff setting (revision), forecast of short - and long-term tariff modifications

The objective is to set or review tariffs, as well as to assess the results of discussions and negotiations over investment, loan, privatization and other plans, which are still in the development stage, and evaluate their impact on future tariffs.

➤ **Licensing of economic entities**

The objective is to insure protection and balancing of the rights of the consumers, Government and economic entities operating in the energy sector through certain conditions imposed on the economic entities.

➤ **Monitoring of licensed activities**

The objective is to assess the efficiency of technical and economical justifications, presented to the Commission with the request for a construction and operation licenses, costs and works performed by the applicants for licensing, as well as regulation of their activities in the power sector through tariff adjustments.

➤ **Participation in the processes of revision and classification of technical norms and normatives acting in the power sector**

These processes shall be performed based on the principles of economic independence of economic entities, as well as system safety and reliability established by the Law of the Republic of Armenia.

➤ **Discussion of disputes and setting rules and procedures for contractual relations between economic entities and the consumers, as well as between economic entities operating in the power sector**

The basis for the activities shall be balancing of the interests in the relations between consumers and suppliers or other power sector entities.

➤ **Establishment of annual mandatory electricity (capacity) generation and purchase quotas for domestic market consumption**

It gives a possibility to limit (prohibit), if necessary, export of electricity produced at the power plants with the lowest tariffs.

➤ **Development of procedures and legal and normative documents necessary for the development of the power market**

The purpose is to stimulate the formation and development of the power market, as well as to ensure balancing of interests of the consumers and market members in the monopolistic operation through setting rules and procedures for their relations (authorities, duties, and responsibilities).

➤ **Increasing public trust in the Commission's decisions**

This issue is addressed through involvement of scientists, professionals, specialized organizations, as well as through ensuring transparency of the Commission's activities.

➤ **Formation of an institution of public consensus**

With the purpose to consider public opinion while approving resolutions, a dynamic work is supposed to be undergoing with NGOs, mass media, as well as different consumer unions.

➤ **Analysis of financial and economic activities of the power sector**

The purpose is to evaluate the efficiency of financial and economic situation and licensed activities in the power sector, creation of database necessary for making decisions on tariff setting and revision.

LICENSING AND MONITORING OF LICENSED OPERATION

During year 2000 the Commission has participated actively in the activities related to the process of privatization of distribution companies, specifically in the development of RoA Law “On Making Amendments to the 1998-2000 State Property Privatization Project and on Privatization of Yerevan Distribution Closed Joint Stock Company, Northern Distribution Closed Joint Stock Company, Southern Distribution Closed Joint Stock Company, and Central Distribution Closed Joint Stock Company”, adopted by the RoA National Assembly on July 28, 2000. Comments, proposals and conclusions on the package of privatization documents (Share Purchase Agreement, Direct Sale Agreement, etc.) have been presented to respective bodies.

New Licenses to be issued after privatization have been drafted. It should be mentioned that the licenses issued by the Commission are the main leverages, through which certain conditions are being proposed to power sector Licensees, balance and protect the rights of consumers, the State and companies licensed to operate in the naturally monopolistic sector. The new licenses include a number of provisions regarding the above said, such as, customer service quality requirements, i.e. the indicators, which in developed countries show the quality and reliability of the service provided to consumers. Certain provisions for power supply to VIP consumers have been established, including power supply in case of limited generation, and cost-related provisions, which establish that all large expenses starting from certain point shall be made through tender with priority to local producers and service providers.

The Commission has also participated effectively in the development of the new RoA Energy Law, which was sent to the RoA Government and other related Ministries for discussion.

Drawbacks and shortages of the old Law have been improved in the new one, and the new Law is now easy and clear, as well as better justified legally, technically and by Law. The relationships of consumers, the Commission, and other authorized state bodies have been clarified, and new provisions conditioned by the necessity for reforms in the power sector have been added (specifically, provisions regarding to setting rules and

procedures for operations in the power market, and further development of the power market).

New model contract of natural gas supply for residential consumption (supplier-consumer) has been developed and approved, which completely regulate the relations between the Parties, their rights and responsibilities. The Contract clearly states the principle of uninterrupted power supply, as well as new reliability and safety requirements.

In compliance with the respective Resolution of the Commission, the Armrosgasprom CJSC was issued a new natural gas distribution license, which, unlike the previous one, clarified the responsibilities of the Licensee; new provisions regarding service quality and protection of consumers' rights have been added. A draft "New procedures for gasification and gas supply restoration" was developed, which was sent to all interested authorities and organizations for discussion.

The Commission presented comments, proposals and conclusions regarding a number of laws (On Licensing, On Energy Efficiency, On Legal Acts) and other draft legal acts developed by other state bodies and submitted to the Commission for discussion.

During year 2000 the Commission with respective Resolutions issued operation licenses to 17 economic entities for operations in different spheres of the power sector, as a result of which 408,0 thousand Drams worth of taxes were paid to the State Budget. Based on the necessity to comply with the provisions of the License and with the purpose to assess the efficiency of costs for creating a database for market costs of commodities and services, technical normatives, standards, technical analysis of applications for licenses, volume of overhaul and current renovation and repair works for electric installations and equipment, in August 2000, a new Licensing Monitoring Department was established in the Legal-Licensing Department of the Commission. The specialists of Licensing Monitoring Department have already performed analysis of the 1999 annual expenses of the economic entities in the power sector, as well as technical analysis of the technical and economic justifications of the applications for construction and operation licenses.

Customer complaints on power supply have been discussed, the technical problems reflected in them have been studied and justified solutions given.

With the purpose to control the licensed operation, as well as accounting and efficiency of the fixed assets involved in the licensed operation, the professionals of the Commission developed a database, which includes complete data on the Licensees in the power sector. Application of computer programs for analysis of reports will greatly improve the efficiency of control over the compliance with provisions of licenses and technical monitoring of the Licensee's activities.

Procedures and deadlines for provision of certain documents, by state bodies to legal entities, necessary for obtaining licenses for construction of new generating capacities were studied. With the purpose to attract investments in the power sector, the results of

the study, as well as Commission's comments were sent to corresponding authorized bodies for discussion.

46 contacts signed by and between the power sector entities were analyzed, studied, and registered by the Commission in established procedures.

TARIFF POLICY

The objective of the tariff policy is to develop, establish, and implement economically justified and publicly acceptable pricing mechanisms. With this purpose, the Commission performed the following actions in the year 2000:

- Taking into consideration the forecasted level of electricity consumption and volume of energy resources for the year 2000 in the Republic of Armenia, year 2000 quotas for electricity delivery to the National Grid were set for generating companies.
- With no change to end consumer tariffs, tariffs for electricity delivered from generating companies in the year 2001, electricity sale tariffs for electricity delivered from Armenergo CJSC wholesale buyer-seller to distribution companies, as well as transmission service tariff for High Voltage Networks CJSC have been set.
- Large groundwork has been performed to transfer to two-part tariff system (energy and capacity), the methodology for calculating the tariff has been developed. At the first stage, starting 2001, the two-part tariff shall be implemented for five large generators and the High Voltage Networks CJSC. Implementation of the two-part tariff shall be based on clear separation of fixed and variable costs of electricity generation, which shall ensure steady revenues, as well as stimulate availability of equipment.
- New methodology for calculating the tariff for electricity delivered from small HPPs has been developed. With the purpose to stimulate hydro power development, a maximum marginal tariff of 3 cents (VAT excluded) for small HPPs to be constructed was established, with the purpose to, first of all, stimulate the construction of the most efficient plants.
- Thermal power tariffs were set for electricity delivered from thermal power plants.
- Central heating tariffs for eight residential areas for the year 2000-2001 winter season were set.
- With the purpose to stimulate the industry of the Republic, a special methodology for calculating sliding tariffs was developed for 13 Atm steam consumers of Yerevan TPP.

- Commission's operation plan for the year 2001 has been developed and presented to the National Assembly. Electricity, thermal power and natural gas balance forecasts have been performed.

The tariff methodology adopted by the Commission is based on the internationally accepted principle of revenue requirement, which ensures operation and maintenance costs necessary for reliable and safe operation of the company, depreciation allocations based on realistic life of main assets engaged in the activity, as well as reasonable profit for companies.

In compliance with the Commission's calculations, the reasonable rate of return on investments in the Armenian power sector for the next several years is within the range of 16%. Lower rate of return will adversely affect private investments into power sector and transfer them to other sectors.

The given rate of return, which is endorsed for five years starting year 2004 in the draft Tariff Agreement with distribution companies, shall be incorporated in the tariff for electricity generated at both privatized and newly constructed small HPPs.

The Commission has developed new approaches for tariff policy to be used for distribution companies after privatization. Based on the requirements of the Law on privatization of distribution companies, a draft Tariff Agreement was developed, which shall be presented to investors as part of the package of privatization documents.

Financial Analysis of Activity of Licensed Companies

One of the primary issues of the Commission is financial analysis of Licensee's activity of Power Sector, which is targeted:

- To estimate effectiveness and financial position of Licensee's activity of Power Sector;
- To form necessary database for decision making with regard to tariff establishment and revision;
- To estimate prediction of financial indicators of the companies which applied to the ERC for receiving License.

The Commission analyzed and summarized interim financial statements of the first, second and third quarters for the year 2000 of the Power Sector Licensees', as a result of which many inconsistencies and defaults have been revealed. As a result of joint discussions with economic entities on Commission's suggestions for the purpose of elimination and amendment of the above mentioned defaults, the quality of the represented financial statements as well as the quality of the financial statements to be represented was significantly improved.

Beginning from the year 2000 accounting in Power Sector 11 major companies is being conducted in accordance with Accounting Standards of the Republic of Armenia (hereinafter ASRA), the implementation of which is aimed at improvement and harmonization of the rules, methods and principles of preparation of financial statements. The Commission developed and implemented new and more improved ways of preparation of financial statements and other information represented by the Power Sector Licensees formed in accordance with the requirements of ASRA and new Chart of Accounts. In the process of implementation of the above mentioned ways, the Commission is willing to acquire comprehensive information necessary for regulation purposes. At the same time, the Commission approved and provided filling order of the statements and procedure for analysis of financial statements to the Licensees.

Taking into account annual results for the year 1999, the Commission performed comprehensive analysis of financial indicators of Power Sector Licensees, in which, particularly, analysis on indicators of liability settlement with regard to electricity generation and delivery, results of financial activity, financial flows and operation costs of companies, specific weight of the fuel, payroll, budget and social security fund. In the process of annual analysis, the Commission with quantitative indicators describing financial activity of Power Sector major companies for the first time has simultaneously applied system of indicators describing financial stability. The results of analysis were published in the Business Plan for the year 2001 of the Commission represented to the National Assembly.

The Commission has also taken part in the development operations of the project targeted to restructuring arrangements of payables and receivables of the Power Sector Companies conditioned by the privatization process of Distribution Networks.

Operations with Consumers

Protection of interests of consumers, their questions, applications and complaints as well as operations targeted to solve the alarm calls due diligently are permanently under the Commission's attention.

165 written and aural (via telephone) applications and complaints, alarm calls were received during the year 2000, 145 of which from the population, 20 from legal entities. Corresponding clarifications were provided to all questions, disputable issues were discussed with participation of interested parties, which were solved accordingly.

Summery of the analysis results of applications and complaints revealed that majority of the brought up issues relates to the wrong recording electricity consumption by the supplier and to non-compliance with contractual liabilities. There are many cases when the facts described in the applications and complaints do not correspond with reality, the study of which reveals that the violations were conducted by the Consumer.

Very often in the process of giving accurate solutions to the brought up issues, imperfection and contradictions in some laws or legal acts hinder the realization of the task. For this reason suggestions by the Commission were represented to the RoA Government with regard to making amendments to some laws or administrative or normative acts.

Operations with the Public

The Commissions regularly informs about its activity via Mass Media. 10 messages, 4 interviews and one essay were published in the press. Public relations service and media published 22 articles and 1 essay with regard to the Commission's operations. New debates and discussions were organized.

The Chairman and members of the Commission as well as staff members highlighted urgent issues regarding the sector during their speeches via National Radio programs "Topic plus" and "Andradarz (reflection)".

The Chairman and members of the Commission as well as staff members disclosed tariff policy, license problems and issues of interest balance of economic subjects and consumers to the public via National TV programs or via private channels.

National TV program "Capital" prepared a film on the Commission's activity and operations and represented comprehensive information to the public.

Relationships with several non-governmental organizations are going on to improve and tighten. Issues on the interests of consumers have been discussed a lot with participation of "Consumers' Union" and other organizations. Their suggestions on the draft of "Model Form of Natural Gas (residential supply) Supply" have been discussed and taken into account.

Cooperation with International Organizations

The commission, emphasizing the importance of investigating the best experience in the sphere of Power Sector dispatching, is cooperating with a number of International Organizations and Regulatory Commissions of a number of countries.

During the year the specialists of the Commission took part in the seminars devoted to investigating the experience of Regional Market implementation, which were organized by United States Agency for International Development (USAID) and Academy for Educational Development (AED), and the results of the discussed issues and the study of the experience of different countries showed that the establishment of a joint Energy System with neighboring countries and the implementation of Market Relations, except considerable economic benefits for Armenia, can contribute to creating serious prerequisites for Regional political stability.

In 2000 the cooperation with the Regulatory Commission of the State of Kentucky, USA, has continued. In August the first-class specialists of the State, during the seminars in

Yerevan acquainted the Commission specialists with tariff formation, development and confirmation, consumer's supply, examination of energy supply quality criteria, defense of the consumers rights, promotion of educational level of the suppliers and activities directed toward competence issues.

The specialists of the Commission participated in the Forums organized by Regulatory Commissions' Association of the USA, with the financial aid of USAID.

In the agendas of the Forums the most urgent issues were raised by the participating countries, suggestions and perspectives on the issues have been discussed and recapped during the sessions.

The specialists of the Commission participated in the regular annual Forum devoted to Power System Regulatory Issues of Central and East Europe and Eurasia in Bukharest, in December 2000. The Tariff Committee Chairman of this constantly functioning structure is the Chairman of the RoA Energy Regulatory Commission.

During the Forum a Regional Association of the regulatory bodies of the mentioned countries was established (ERRA), the goal of which is to ensure the exchange of information and experience among Power System regulatory bodies and the development of joint procedures concerning dispatching issues.

The Chairman of the Commission is elected a member of the Presiding Committee of the Association of 15 countries.

The Commission is participating in project discussions, expert evaluations of reporting activities, as well as in the development of new technical tasks that are carried out in Armenia by USAID, TACIS, UNDP and other organizations. Taking into consideration the future opportunities of implementation of new energy technologies (wind, sun, etc.) the Commission is actively cooperating with foreign partners to investigate and consider the peculiarities of price formation and legal ground in those spheres.

Financial Statement on Activity of the RoA ERC

The RoA ERC was financed from the RoA State Budget Resources in the year 2000

N	Name of the Cost	Approved budget/adjusted/ /thous.drams/	Financing /thous.drams/	Actual cost /thous.drams/
1.	Salary	51974.0	51974.0	51974.0
2.	Obligatory social payments	9949.5	9949.5	9488.0
3.	Stationery and materials	2128.0	450.0	778.7
4.	Business trips	1870.0	1850.0	1864.0
5.	Communication fees	3463.7	1533.8	3521.8
6.	Electricity, fuel and heating costs	1650.0	1100.0	1820.4
7.	Sewage system payment	60.0	25.0	60.0
8.	Transportation payment	6080.0	3050.0	4497.6
9.	Representative costs	350.0	50.0	50.0
10.	Other service acquisition costs	1700.0	---	---
11.	Lease payments for buildings and equipment	14310.0	7630.0	11280.0
	TOTAL	93535.2	77612.2	85334.5